Date of Hearing: April 16, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
AB 1680 (Wieckowski) – As Amended: April 9, 2012

SUBJECT: Dissenting shareholders' rights.

SUMMARY: Makes various changes to California's dissenter rights law. Specifically, this bill:

1) Establishes that the fair market value of shares publicly traded shall be the most recent closing price per dissenting share prior to the first announcement of the terms of the proposed reorganization or short-form merger.

2) Provides that the fair market value of dissenting shares that are not publicly traded shall be determined as of the day before the first announcement of the terms of the proposed reorganization or short-form merger.

3) Eliminates the provision making holders of publicly traded shares only eligible to receive the fair market value of their dissenting shares if 5% or more of the shares are dissenting shares.

4) Re-defines "dissenting shares" to include publicly traded shares for which the holder is entitled to anything except publicly traded shares of another corporation or cash in lieu of fractional shares, or a combination of those shares and that cash.

EXISTING LAW

1) Defines "dissenting shares" as shares which come within all of these descriptions:

   a) Which were not immediately prior to the reorganization or short-form merger listed on any national securities exchange certified by the Commissioner of Corporations, and the notice of meeting of shareholders to act upon the reorganization summarize this section and Sections 1301, 1302, 1303 and 1304; provided, however, that this provision does not apply to any shares with respect to which there exists any restriction on transfer imposed by the corporation or by any law or regulation; and provided, further, that this provision does not apply to any class of shares if demands for payment are filed with respect to 5 percent or more of the outstanding shares of that class.

   b) Which were outstanding on the date for the determination of shareholders entitled to vote on the reorganization and were not voted in favor of the reorganization or, were held of record on the effective date of a short-form merger.

   c) Which the dissenting shareholder has demanded that the corporation purchase at their fair market value.

   d) Which the dissenting shareholder has submitted for endorsement. [Corporations Code, Section 1300]

2) Defines "dissenting shareholder" as a record holder of dissenting shares and includes a transferee of record. [Corporations Code, Section 1300]

3) Provides that fair market value is determined as of the day before the first announcement of the proposed transaction. [Corporations Code, Section 1300]

4) Provides that the dissenter's rights statute applies to a public company where there exists any restriction on transfer with respect to the shareholder's shares or in excess of 5% of the outstanding shares of the public company voting on the transaction dissent. [Corporations Code, Section 1300]

5) Requires the corporation to notify holders of dissenting shares of the approval of reorganization, description of dissenters' rights and the price the corporation believes is the fair market value of the shares. The shareholder in turn must make a written demand to be cashed out within prescribed time limits. If the value of the shares is agreed upon, then the corporation must pay the agreed upon price plus interest. [Corporations Code, Section 1301]

FISCAL EFFECT: None.

BACKGROUND:

Historically, during the early evolution of corporate law in the United States, major corporate actions, such as mergers required the unanimous consent of the corporation's shareholders under the common-law theory that each shareholder had a vested property right in the terms of the corporation's charter and that property right could not be altered without the individual shareholder's consent. This presented a serious complication for efficient operation and effective corporate action and allowed the minority, even a single shareholder to frustrate the will of the majority and/or engage in strategic action to exact special consideration in certain circumstances. The dissenters' rights remedy developed as a legislative remedy to protect minority shareholders from being forced out of their investment at an unfairly low price and to compensate them for the loss of their common-law right to preclude a major corporate action, while at the same time operating to facilitate the occurrence of mergers. Today, the dissenters' rights is to provide shareholders who dissent from a merger or other specified major corporate action with an independent judicial determination of the fair value of their shares.

The basis for dissenters' rights provisions contained in the Corporations Code (Sections 1300-1312) is that shareholders who disagree with the majority of shareholders in a corporate reorganization or merger of one corporation with another, should be able to have their shares cashed out by the corporation at a fair market value instead of accepting the share for share exchange or cash price arrangement approved by the majority shareholders. The new investment share may be inimical to the investor's original reason for investing in the corporation, and, if the corporation is closely held, the shares can be difficult to liquidate. In turn for the ability to cash out, the law generally prohibits these minority shareholders from seeking to invalidate the reorganization or merger in court, and their only recourse to legal action is limited to a judicially backed appraisal of fair market value when there's a disagreement over the value of the share.

As for publicly traded shares, dissenters' rights are with few exceptions nonexistent because these shares are easily sold on a stock exchange for their fair value. The exception to this rule is where publicly traded shares held by dissenting shareholders make up 5% or more of the

outstanding shares. In this instance, these shares are accorded full dissenters' rights because it is believed that the magnitude of this number of shares dumped on the market at one time would adversely affect the sales.

NEED FOR THE BILL:

The California Dissenters' Rights Statute includes an exception that creates a dissenters' appraisal remedy for shareholders of a public company where holders of more than 5% of the shares of the public company properly dissent and seek such an appraisal remedy. According to the Author, the 5% exception which the proposed legislation eliminates can result in undesirable uncertainty over the ability of a public company to successfully consummate a stock-for-stock merger that has been approved by the public company's Board of Directors and potentially make the public company vulnerable to stock speculators who accumulate shares in the public markets for the sole purpose of potentially enriching themselves at the expense of other long-term minded shareholders who support the proposed transaction.

The Author goes on to state, the problem arises because in a stock-for-stock merger transaction the acquirer proposes to purchase all shares of the target public company by paying to the shareholders of the public company shares of the acquirer's stock at an agreed upon exchange ratio. The acquirer in such a transaction is often concerned about the impact of the California Dissenters' Rights Statute because if the holders of greater than 5% of the shares of the public company dissent, the acquirer will need to pay the dissenting shareholders an amount in cash equal to the fair market value of such shares. The acquirer will seek to avoid that risk because it may increase the cost of the transaction to the acquirer or require that the acquirer pay cash rather than shares of its own stock to purchase the shares from the dissenting shareholders of the public company. In order to avoid that risk, the acquirer will often require that the public company agree to make closing of the transaction conditioned upon a limited number of shareholders of the company perfecting their appraisal rights. Such a contractual arrangement has the effect of putting the transaction approved by the Board of Directors of the public company at risk if an excess number of shareholders dissent.

According to the Author, California's 5% Exception imposes unnecessary restraints on public companies, invites stock speculation and consequently forces California companies to consider drastic measures, such as reincorporating into a different jurisdiction, to avoid the operation of California's Dissenters' Rights Statute. Further, public companies are often forced to agree to merger provisions that put the transaction at risk to the extent that their shareholders choose to dissent, rather than sell their shares in the open market.

AB 991 FIX

AB 991 (Silva) chapter 131, Statutes of 2009, updated references to the Nasdaq Stock Market, as it had become a national securities exchange in 2006. However, due to the way in which AB 991 was drafted, the amendments inadvertently appeared to modify the requirements under Corporations Code, Sections 1300 and 1301 affecting how shareholders of a Public Company perfect dissenters' rights. AB 991 deleted the provisions that distinguished Nasdaq from the reference to other national securities exchanges.

According to the Author, since 2009, California's Dissenters' Right Statute, and in particular, Sections 1300(b) (2) and 1301, has been repeatedly misinterpreted by California practitioners.

Indeed, in surveying transactions involving public companies since 2009, it is clear that the AB 991 created confusion on the correct standard to be applied for perfecting dissenters' rights. California practitioners have misinterpreted California's Dissenters' Rights Statute by requiring shareholders of public companies desiring to perfect dissenters rights to only refrain from voting in favor of the transaction and make written demand on the corporation within 30 days after the corporation provides the shareholder notice that the transaction has been approved by its shareholders.

FAIR MARKET VALUE

The California Corporations Code fixes the fair market value of a dissenting share as the closing price for such share on the day before the transaction is first announced. The consequence of these provisions is that if the price of shares or the fraction of a share of acquirer stock being offered in exchange for a share of the public company were to decline after announcement of the transaction to an amount that is less than the price per share of the public company on the day before announcement, speculative shareholders may seek to exploit the situation by purchasing sufficient shares to trigger appraisal rights which may have the effect of either preventing the transaction from closing or allowing the dissenting shareholders to receive additional payments from the public company at the expense of the majority of shareholders who have approved the transaction and will continue to own shares of the surviving company.

Corporations Code, Section 1300(a) provides that shareholders that perfect dissenters' rights are able to seek "fair market value" for their shares, and that "fair market value" is to be determined as of "the day before the first announcement" of the proposed transaction. This provision, as currently drafted, leaves open the question of how to properly determine "fair market value" of publicly traded shares when the transaction is announced after the close of trading on a day in which the markets are open, a standard approach to announcing the merger of a public company.

To ensure that the most applicable date is used for determining the fair market value of dissenting shares under California's Dissenters' Rights Statute as it relates to Public Companies, and to ensure consistency among practitioners, the standard should be linked to the date of the most recent closing price prior to the announcement of the transaction (regardless if a transaction is announced before the market opens, or after the market closes). In using this standard for public companies, practitioners will be more consistent in determining the correct date for purposes of establishing "fair market value" and it ensures that the most current market price is used for the determination.

DELAWARE

The changes made in AB 1680 would make California's Corporation Law more similar to Delaware's laws. Delaware is seen as a more corporation friendly then a number of other states. Delaware continues to be the favored state of incorporation for U.S. businesses. Delaware has been preeminent as the place for businesses to incorporate since the early 1900s, and its incorporation business, supplemented by the growth in numbers of such "alternative entities" as limited liability companies, limited partnerships and statutory trusts, continues to grow smartly. Close to a million business entities have made Delaware their legal home. Furthermore, while the sheer number of corporations organized in Delaware is significant, more significant still is the fact that so many large and important corporations are incorporated in Delaware. Of the corporations that make up the Fortune 500, more than one-half are incorporated in Delaware.

Delaware has become almost a brand name for the "business" of serving as the official home for corporations.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

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